~~Book~~ Review: The Problem With Banks

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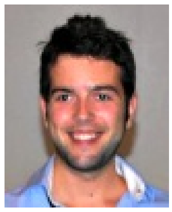
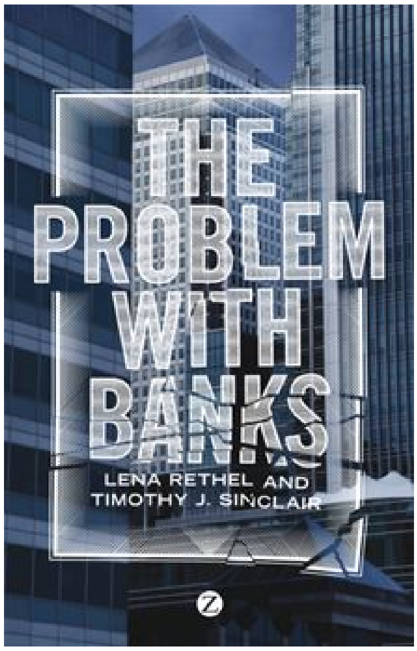
*In **The Problem With Banks**, **Timothy J. Sinclair** and **Lena Rethel** argue that banks suffer from perennial problems, and that developments in the financial markets and government in recent decades have simply exacerbated these issues. This book is an interesting and highly recommended read, not just because Rethel and Sinclair explain how the role of banks shaped the financial crisis, but because they show how important it is to change the position of banks within our economies, writes **Carlos Carrasco Farré**.*



The Problem With Banks. Lena Rethel and Timothy J. Sinclair. Zed Books. May 2012.



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The Problem with Banks considers one of the key political and economic issues we face in the early decades of the twenty-first century. The bailouts associated with the US sub-prime crisis alone may cost as much as $5 trillion. Also, if we take into account the European crisis, this figure becomes stratospheric. According to Reinhart and Rogoff (in *This Time is Different: Eight Centuries of Financial Folly*), the modern banking crisis has resulted in an average increase of government debt by 86 per cent during the three years following the crisis. With these figures in mind, it is absolutely understandable that the public seek to ask what the problem has been with the banks and why they seem to be at the centre of economic and financial turmoil during this systematic crisis under which we have all suffered. It is also absolutely understandable for the public to ask why the banks have come to play such an important role in everyday economic and political life, despite their seemingly troublesome nature.

In their book, *The Problem with Banks*, Lena Rethel and Timothy J. Sinclair (both associate professors of International Political Economy at the University of Warwick) try to answer these questions, examining banking in America, Asia, and Europe, and the circumstances that have driven the banks' attitude towards risk. This book is certainly worthwhile for readers looking for a concise, clear and accessible text on what is happening around financial markets. The book includes some basic statistics and graphs, but they are easy to understand. Readers interested in deeper technical information are also catered for, as the authors rely on a large number of perfectly referenced academic studies to discuss the structure of the global financial system.

The main thrust of the book is an overview on how government plays a major role in shaping banks' motivation and behaviour, and how banks evolve as institutions alongside states: "Unlike most other books about banks, which assume banks are given or natural, we argue that government has a major role in creating and shaping bank behavior. Government does not just regulate banks, but actually creates or constitutes what banks are and what banks do." The book is structured in six chapters. The first two chapters are a mix between theoretical affairs on banking as a confidence game, and the history of banks. Chapters three and four cover financial innovation, self-regulation, and risk-taking, with the fifth chapter and the conclusion discussing reform proposals and problems.

The traditional definition of banks describes them as institutions created to fulfil certain functions in society, such as to safeguard deposits, and to intermediate between savers and borrowers. This definition, still in use in certain circles of thought, assumes that bank operations follow a rather timeless, functionalist logic. The authors write that instead banks have to be considered in terms of the specific historical circumstances they face, especially since these circumstances have changed the identify of banks from market authorities (the traditional definition) to market participants, transforming their behaviour and appetite for risk. In other words, to understand banks we must understand their link with states and how this has changed over time.

Banks are not an invention of the capitalist era. The existence of institutions that fit the traditional definition of banks dates back several millennia, back to ancient Egypt and Mesopotamia. For thousands of years, banks had to fulfil the classical functions of safeguarding deposits or deal with defaulting sovereigns. The paradox is that nowadays states have increasingly come to incur the costs of defaulting banks, leading to new problems. The responses to the banking crisis have now shaped the boundaries for future financial arrangements, setting the pathologies for future crises. So, the authors argue, public policy shapes the motivation and behaviour of banks.

In order to re-define banking and re-design bank regulation, Rethel and Sinclair consider the writing of philosopher John Searle, particularly his 1969 work *Speech Acts*. Searle suggested it is possible to distinguish between regulative rules that “regulate antecedent or independently existing forms of behaviour, from a much more architectural form of rule that do not merely regulate, they create or define new forms of behaviour” (Searle 1969). Rethel and Sinclair claim that most concerns about banking are focused on the regulative kind of rules (questions of how we regulate banks better), while it is the constitutive rules that actually matter most. States and financial regulators have focused on designing rules for existing banking operations without paying attention to what made this activity possible in the first place. And the most important thing: if this activity is risky, as it has shown itself to be not just for finance but for the economy and society as a whole, then there must be a deeper change than just more regulative rules.

In conclusion, the authors propose three major fundamental insights about banks: firstly, that banks have changed beyond recognition; secondly, that we are responsible for what banks do; and thirdly, banks can work for us. However, this reviewer feels that the authors give too little attention to the possible solutions. Approximately, 85 per cent of the book is a description of the banking system and its problems, with just 15 per cent focused on what is to be done. The authors do a great job explaining the problems with the banking system but readers eager for strong detailed solutions may be disappointed.

This book is an interesting and highly recommended read, not just because Rethel and Sinclair explain how the role of banks shaped the financial crisis, but because they show how important it is to change the position of banks within our economies. Many similar books have been published offering answers to the financial crisis, but the argument of this book goes beyond them: it will not be enough with new regulative rules as most of books propose, we need deeper reform that will truly shape the behaviour of banks and deal with the purpose of these institutions.

Carlos Carrasco Farré is a researcher at IESE Business School “Cities in Motion Strategies” and analyst at Planol.info. Carlos holds a BA in Political Science from Pompeu Fabra University and a MSc in Public and Social Policy from Pompeu Fabra University and Johns Hopkins University. He also took some courses at the LSE and Bloomberg School of Public Health at Johns Hopkins. He has previously worked as consultant for several local governments and for the economic development agency of Barcelona. Read more reviews by Carlos.